OFFICE OF LEGISLATIVE LEGAL SERVICES
COLORADO GENERAL ASSEMBLY

STATE CAPITOL BUILDING, ROOM 091
200 EAST COLFAX AVENUE
DENVER, COLORADO 80203-1782

TELEPHONE: 303-866-2045
FACSIMILE: 303-866-4157
E-MAIL: olls.ga@state.co.us

SUMMARY OF MEETING

COMMITTEE ON LEGAL SERVICES

March 18, 2009

The Committee on Legal Services met on Wednesday, March 18, 2009, at 7:35 a.m. in SCR 356. The following members were present:

Senator Veiga, Chair
Senator Brophy
Senator Mitchell
Senator Morse
Senator Schwartz
Representative B. Gardner
Representative Labuda (present at 7:47 a.m.)
Representative Levy
Representative McGihon, Vice-chair (present at 7:38 a.m.)
Representative Roberts

Senator Veiga called the meeting to order. She said we're here to consider House Bill 09-1292. We're sitting today as the Senate committee of reference for the rule review bill.

Debbie Haskins, Senior Attorney, Office of Legislative Legal Services, addressed the Committee. She said this is the annual bill on rule review from the Committee. The bill contains the Committee's recommendations on executive branch agency rules that were reviewed by the Office and the Committee. All the rules adopted by the various state agencies and boards from November 1, 2007, to November 1, 2008, are extended except those that are specifically listed for expiration in the bill. The rules that are listed that way will expire on May 15, 2009. The rules that are being allowed to expired are those that the Committee determined either conflict with state law or are beyond the statutory authority of the agency to adopt. While the Committee was sitting as the committee of reference on the bill in the House on March 6,

the Committee acted on the staff's recommendations on the oil and gas conservation commission rules on practice and procedure. The reengrossed version of House Bill 09-1292 contains the Committee's recommendations on the oil and gas conservation commission rules. Briefly, the Committee voted to repeal three rules that are listed in the bill and those will expire, effective May 15, 2009. The Committee voted to extend the remainder of the rules, effective May 15, 2009. There were no changes in the House on second or third reading to the bill, so the bill that is before you today reflects the way the bill left the Committee on March 6.

Senator Veiga said there are three folks signed up to testify. I do want to thank everybody in the audience. I know I've been somewhat discouraging of having a repeat of the eight hours of testimony that we had at the last hearing and I very much appreciate everybody's cooperation in trying to limit testimony today.

7:38 a.m. -- Ken Wonstolen, Attorney, Colorado Oil and Gas Association, testified before the Committee. He said I came back today just to address one of the issues that we talked about two weeks ago, which relates to the appeal rights that have been granted in Rule 503. As I think the Committee knows, subsequent to the hearing we had on Friday, March 6, the commission has docketed a rule-making to address the appeal rights granted to the department of public health and environment and the division of wildlife. The commission has docketed a rule to strike those two appeal rights. It may be within the Committee's discretion and the appropriate policy to simply save people the time and effort of going through the rule-making and to strike those. I wanted to address just briefly the remaining appeal right we had an issue with, which was the surface owner appeal right. We've done some further research and pulled up a memorandum from 2001 from the Office of Legislative Legal Services to this Committee. This memo was looking at rule-making authority of the medical services board and, in that case, they found that the board had essentially created a protected class on its own. I think that has an analogy to what has occurred here with respect to the surface owner appeal. One paragraph in the memo that's pertinent said the board has exceeded its rule-making authority by creating a new protected class on its own, rather than using its rule-making authority to implement the policy of the General Assembly. The board has made new policy without direction from the legislature. Without a specific delegation, the board lacks the authority to assume the legislature's policymaking role. I think that is analogous to what we have here with respect to surface owners. There was certainly no directive in either House Bill 07-1341 or House Bill 07-1298 telling the commission to create an essentially protected class of individuals with respect to the ability

to appeal applications for permits to drill (APDs), which is what they've done with respect to surface owners. To the contrary, this legislature has spoken comprehensively over the years about the will of the commission with respect to surface owners. That involves ensuring they have advanced notice of the activity and that they are financially secured when they do not have a lease or surface use agreement in place against unreasonable crop loss or land damage. Further, in the same year the two bills that underpin these rules were adopted, we did have House Bill 07-1252, where, again, the legislature spoke directly and comprehensively about the relationship of oil and gas operators and surface owners. I think, given the comprehensive legislative scheme over the years that the General Assembly has adopted in this area, and the lack of any specific directive in those bills, that we have an analogous situation to what we had in this medical board issue where the rule-making authority has created a new protected class of parties with respect to the ability to hold up an APD. Keep in mind, this is the ability to stop the APD from being issued, after it has been approved by the director, and subjects the operator to an adjudicatory appeal in front of the commission. I wanted to renew our request to reexamine the issue in light of this previous precedent that we have come up with.

Senator Morse said Mr. Wonstolen has suggested the commission exceeded their authority, but what about the fact that, in statute, we've granted broad authority to the commission and have said something to the effect that just because we grant you specific authority, like in House Bill 07-1252, that doesn't mean that we are limiting the broad authority we granted you? What's your argument to say this is outside the authority? Mr. Wonstolen said that's the crux of the issue. If the authority granted is so broad given this other provision about nothing specific is in derogation of the general powers, you have no effective check essentially on what the rule-making authority has done. I think if you look at the precedent here, what they're saying is that without a specific directive from the legislature and in the face of a comprehensive scheme adopted by the General Assembly over the years, the rule-making authority does have some constraints. I think the issue is does that very broad general authority that's granted to the commission simply mean they get to do whatever it is they want and there's no check here? I don't think that's an appropriate function or role. I think Representative Roberts asked the question about taking into account what was going forward in 2007. We had six major bills and I think staff told you you do have the right to take into account what it was you were trying to accomplish. Again, I think that what we're asking you to rethink is what were you trying to accomplish in this area? You did adopt House Bill 07-1252 to address surface owner issues. You made no directive with respect to providing appeal rights to surface owners. There is another provision in law in the "State Administrative Procedure Act" (APA)

that says the mere fact that a rule does not conflict with a provision of statute doesn't provide the authority for that rule. I think you have to still point to some authority beyond just the general provision that the commission has broad rule-making powers.

Representative Roberts said she and Mr. Wonstolen talked a lot in 2007 on House Bill 07-1252. Going to the issue Mr. Wonstolen is discussing, my concern is the point of House Bill 07-1252 was to early on get the surface owner and operator talking and getting to an agreement, and essentially putting them on level playing fields. As you know, I'm a strong advocate of the surface owners' rights. My concern about this particular section of the rules, though, is this second bite of the apple that a surface owner would get, which could very well undermine that agreement occurring much earlier, because the operator would be disincentivized to reach that agreement because there's always going to be another crack at it. My question is, practically speaking, does this rule-making as it's currently arranged undermine the surface owner in coming to that agreement with the operator? Mr. Wonstolen said I think that's a concern that the Colorado oil and gas association and many industry parties expressed during the course of the rule-making. Of course, we were unsuccessful in convincing the commissioners of that position, but I think Representative Roberts hit exactly the issue. We have not only the House Bill 07-1252 directive to seek a surface use agreement or accommodate the surface owner, we have existing, up-front procedures in the commission rules, such as the advance notice, the good faith consultation rule, and the on-site inspection policy, which are all designed to get these issues addressed up front and provide an incentive to do that. Now we have this opportunity for surface owners to bring forth broad claims under the rubric of public health, safety, welfare, and the environment after the APD has been decided on and approved. I think that does throw both uncertainty at the back end to this and to disincentivize getting it resolved at the front end. The fact is about 15% of the time the operator is not covered by an agreement, either a lease or a surface use agreement, with the surface owner. We have recalcitrant surface owners and this is a lever now available to them to not engage in that up-front process and to have some opportunity at the end of the day to throw a monkey wrench into the proceeding.

Senator Morse said a couple of follow up questions to that. One, on the 15% that don't have an agreement, how does that work for those of us that aren't really familiar with this industry? Do you get to force them to do something and then you're saying they can use this process to counteract that force? Mr. Wonstolen said you have an existing provision in section 34-60-106 (3.5), C.R.S., which says unless you have an agreement with the surface owner, that

can either be a lease from the surface owner where they own the minerals or a surface use agreement where they don't own the minerals, then there is a financial insurance requirement imposed on the operator to protect that surface owner against unreasonable crop losses and land damage. So, there is a mechanism there. With respect to that 15% or so where, even though an effort is made pursuant to House Bill 07-1252 to reach that surface agreement, you can't get there at the end of the day, and you essentially go ahead and drill the well, and the surface owner has this financial security held by the commission to protect them. They can proceed against that if they have a claim. That's the way it happens under the existing system.

Senator Morse asked under this new appeal rule, how does that change the process Mr. Wonstolen just described? Mr. Wonstolen said under the existing process, if you make the effort and you can't get there with a surface owner, you proceed and go ahead and drill the well pursuant to the permit issued by the commission. Under this new procedure, the surface owner can, by right, stop that permit issuance in its tracks and force you into an adjudicatory proceeding in front of the full commission. At that point, you have no assurance as to when you will see that permit and what other conditions might be imposed by the commission. They bring that appeal, not on the basis of their objection to your contractual relationship between the property interest, but under the rubric of a public health, safety, or welfare concern, which is so broad it covers virtually anything.

Senator Morse said both in that circumstance and in the other circumstance where you do have an agreement with somebody, say the surface owner still decides to appeal. They have to file that appeal within 10 days of the time that the permit is issued and then the commission has to hear it at their next hearing. Isn't it true that even in cases where somebody does file an appeal, it's handled in such an expedited fashion that it really wouldn't be that much of a burden to the industry to jump through that extra hoop? Mr. Wonstolen said it's not quite right to say they have to appeal within 10 days of the issuance of the permit. They're informed of the decision to approve the permit and whatever conditions are going to be put on that, and then the permit sits in a holding box for 10 days for the appeal to be filed. Then, assuming that you have the adequate time to achieve the required statutory notice before the very next hearing of the commission, you can presumably get on the schedule for that next hearing. If you can't get the 20-day notice in before that next hearing, then you'll be pushed back another hearing. The duration of the adjudicatory hearing is not certain. It could be continued. For instance, the commissioners could say they want to hear more information or something like that. You have no guarantee that you're going to see that, and that's the

problem the industry has had about this back end appeal that is appended to what is already the most lengthy permitting process in the nation, considerably longer than the national average. Even when you go through all that and you've had all these up-front opportunities to provide comment and consultation, including the surface owner's right to extend the comment period, even when you get to the end of that road and you get a decision from the director, you're still not done and you have no real assurance. In today's industry, which is almost like a manufacturing enterprise, with time and inventory controls, that provides a level of risk that we just don't see elsewhere.

Senator Morse said but realistically, you do these things six, eight, 10 months ahead of time. You don't get the permit on day 10 and start drilling on day 11. Realistically, you get the permit on day 10 and start drilling on day 180, 190, or 210. There would be time for this to run its course. Isn't that true? Mr. Wonstolen said that may be true for larger companies that have large staffs who can do all that advanced planning, build inventories of permits, and make that investment to get those all in place, but that's not true probably for smaller companies who may learn they have a limited window of availability of a drilling rig if they can move quickly, or it's not true in situations where someone's been unable to drill up a lease and toward the end of the lease says I'm going to have to recoup something by selling this to someone else, and they now have a time crunch to get a well sputted to keep that lease alive. There are many sorts of industry business considerations that go against the general notion that you can simply plan all this out months and months in advance.

Representative McGihon said I want to go back a little bit to the question of protected class. Who is the new protected class and doesn't it include operators? Mr. Wonstolen said the new protected class is the surface owner now having the right to suspend the issuance of a permit and take it to an appeal. I don't believe it includes operators whatsoever. The operator is the person who has the property interest at stake, which is being regulated by the state. The operator has always had the standing to take an appeal of a decision. For instance, if you look at Rule 303.k., which is an existing rule, if the director withholds the issuance of the permit based on reasonable cause to believe there could be a material violation of the act or the rules or a threat to public health, safety, and welfare, the operator has the right to invoke an emergency hearing of the commission for an order rescinding the director's decision on that. That's in the existing rules, so the notion that the commission has created a new class protecting the operators is untenable. They have the ability implicitly, if not explicitly, to address the delay of their property rights being regulated by the state.

Representative McGihon said it does seem to me, though, that there are some rules that you asked the Committee to keep in that staff had recommended might have been beyond the statutory authority that do create a protected class for the operator in terms of consultation and those kinds of things. We kept them in because we said the statute does give broad authority to the commission. Mr. Wonstolen asked are you talking about the consultation with the division of wildlife?

Representative McGihon said the beginning consultation rules. Mr. Wonstolen said I don't recall the staff memo addressing anything other than the issue of who initiates the consultation on the wildlife issues, which is, I think, a different type of matter.

Representative McGihon said my point is that there are some rules in here now that do protect the operators and some rules that don't go as far. The surface owner, you're saying, is a new protected class. I'm not sure I would agree with you. There are rules in here that create advantage for the operator that the operator hasn't had before, that the surface owner has a right under all these bills already, and that the agency does have broad authority under the statute. I think there's gain both ways, is what I'm suggesting. Would you agree? Mr. Wonstolen said no, I don't think I would agree on that. I think, in general, we find that the burden of the regulatory system has been increased virtually across the board and not reduced with respect to any of our operations.

Senator Veiga said let me follow up on that point because I was under the impression that after the enactment of the rules, there was a broadening of the rights of the operators in order to seek an appeal of a director's decision. Can you tell me is that accurate? Mr. Wonstolen said I've heard Director Dave Neslin characterize it that way. Personally, I disagree with that characterization. The operators, and I've cited to you Rule 303.k., have the ability to invoke an emergency hearing of the commission on the denial or withholding of a permit by the director. That's in the existing rules; it's been in the rules for many, many years. I think just, in general, it is a given that the party whose property right is being regulated by the state action has the right to make an appeal about the effect and imposition of that regulation. The notion that by now explicitly or expressly saying the operator has the right to appeal the conditional approval is, I think, just putting into words a right that has always existed.

Senator Veiga said not explicitly existed. Is that your point? Mr. Wonstolen said it does explicitly exist in Rule 303.k. and that's beyond simply appealing a condition of approval. That's where the operator has withheld the permit and

the operator has the right, and it doesn't require notice to anyone, to get an emergency hearing of the commission and an order rescinding the director's decision. That goes beyond just disagreeing about conditions of approval and that's been explicit in the rules for many years.

Representative Levy said I'm wanting to focus in on this notion of a brand new protected class. I may grant you that, but this brings a new party to the table. I think the issue is whether the statute allows the commission to promulgate rules that give the surface owner a seat at the table. I'm not sure it's entirely analogous to the rule that you cited or the opinion that you cited on those other rules. We don't know what the rule is and we don't know what the statute says. I've been operating on the assumption all along that the "Colorado Habitat Stewardship Act of 2007" [House Bill 07-1298], which triggered this rule-making, was intended to shake up the process. It states explicitly that the commission shall administer this article to minimize adverse impact to wildlife resources. The commission shall provide for commission consultation and consent of the surface owner on permit-specific conditions. It seems to me that this statute actually does grant explicit authority to give the surface owner a seat at the table. If the purpose of this statute was to bring wildlife resources, public health resources, and surface owner interests to the table, and you've argued in previous hearings that the agency that is delegated the authority to protect wildlife shouldn't be able to appeal, the agency that's delegated authority to protect the public health shouldn't appeal, and now the surface owner shouldn't be able to appeal, how do we actually achieve the intent of this habitat stewardship act if you're knocking everybody off one-by-one saying they're not granted standing and they don't have a seat at the table to achieve the purposes of the act? Isn't that what an appeal is for, if the permit has been issued and it hasn't been consistent with the rules, thereby not complying with the act? Mr. Wonstolen said first of all, I'm not sure House Bill 07-1298 is really the relevant statute on this issue. I think House Bill 07-1341 is the relevant statute. We're talking about whether or not we have a timely and efficient procedure for the review of joint permits, not whether or not appropriate best-management practices or wildlife measures have been adopted. I think it's really the provision of House Bill 07-1341 that's incorporated into this rule that is at stake here. The provision you're talking about in House Bill 07-1298 for obtaining surface owner consent to wildlife conditions of approval has nothing to do with saying surface owners may convert their input into wildlife conditions of approval into an appeal of the APD, and we have the whole Rule 1202.e., which we talked about, which is a relevant issue here. We're really looking at the directive to establish a timely and efficient procedure for the review of joint permits, which the only new thing you told the commission to do with respect to that procedure was to

provide an opportunity for comment by the division of wildlife and the department of public health and environment. House Bill 07-1341 said nothing about extending that comment or consultation to surface owners. I think it's relevant that at the same time that bill was being adopted, the legislature was considering adopting House Bill 07-1252, which was this comprehensive look at how the relationship between the oil and gas operators and the surface owners should operate. I'm not sure I read House Bill 07-1298 whatsoever to be applicable to this issue I'm raising today.

Representative Levy said I guess I hear your legal argument being that we've granted standing, for lack of a better word, to a category of people who the statute did not contemplate being involved in that process. I think you're looking at this too narrowly by asking is this a timely and efficient process and did the specific provision governing the process explicitly allow those people a seat at the table. I think we have to look at the totality of the oil and gas drilling environment to see whether surface owners are an appropriate party to be at the table. I think you're really arguing with the fact of an appeal right for any party whatsoever and I think it's kind of antithetical to the whole administrative process to say that an agency can issue a permit and that's final and there's no review right. The alternative is to file a civil action and that certainly isn't timely and efficient. I think it's a basic part of the APA that if an agency takes final agency action, there should be some further follow-up appeal right. And who's going to have that appeal right? What's the interested party? I think you have to look at the statutory context much more broadly to determine who would be an interested party. Mr. Wonstolen said I think there's a distinction made between what are essentially administerial decisions like permits, building permits for instance, where there shouldn't be an opportunity, at least in the administrative appeal setting, to have parties come in and suspend the issuance of those administerial acts and throw it into this adjudicatory posture. If someone wants to go to court and say this permit shouldn't have been issued, they can seek a preliminary injunction or a temporary restraining order and the court will make some judgment on the merits as to whether or not they should be granted that. That's a high hurdle to get over and more than likely the operator is going to be able to proceed with the activity. They're not going to be able to stop the activity. Here, you have a 10-day period in which someone can just decide that they're going to stop the activity, take you to a hearing, and put you through your evidentiary requirements. I think you can make the distinction between having that available for these essentially administerial decisions as opposed to orders of the commission that are fully considered in front of the commission.

Representative Roberts said I guess I'm a little confused about why we would

say that without the appeal right the surface owner doesn't engage in the rule-making. I'm looking at Rule 306.a., which requires consultation with the surface owner, including a good faith consultation provision. I guess I have a few questions, the first one being if there wasn't that appeal right that we're talking about right now, certainly there is engagement perhaps even through the local government. I think I know the answer, but would Mr. Wonstolen confirm it? Mr. Wonstolen said I think you're correct. There are essentially three steps early in the process to engage the surface owner. One is the requirement of advance notice and that was expanded in the rule-making so we not only have the 30-day statutory advance notice requirement, we now have a second landowner notice requirement that provides the notice of the filing of the Form 2A and a copy of the 2A, an informational brochure, and so forth. So, we now have dual notice going to the surface owner. We do have the existing Rule 306.a., a good faith consultation requirement, that has been in the rules for a number of years. The commission also has what they call the on-site inspection policy, where if that process doesn't work out, the surface owner can bring the commission staff out for an on-site inspection. The local government designee can be invited to that if the surface owner so desires. I think it has always been the understanding that, to the extent the surface owners could not resolve their issues through these dual procedures, they could see if their local government designee felt that what they were raising had merit, and, in that case, the local government designee had an appeal right in front of the commission traditionally. There are plenty of protections built in for surface owners, as Representative Roberts suggested, without giving them the individual right or status to come in and stop the issuance of the permit themselves and raise these peripheral issues.

Representative Roberts said I know I was a bit repetitive in previous discussions on this bill with the phrase "timely and efficient", but in House Bill 07-1252, which is not part of the rule-making, do you recall that we used the words "technologically sound" and "economically practicable"? I guess my question is, as those three bills moved through the legislature in 2007, there was a consistent theme of "timely and efficient" that would be "technologically sound" and "economically practicable", but not trying to be obstructionist. Mr. Wonstolen said that's what we're suggesting. You have addressed this issue in a comprehensive fashion and you did not provide specific directive to the commission in House Bill 07-1341, or House Bill 07-1298 for that matter, to create this new protected class of individuals who have the right to stop the permit in its tracks and take the matter to an adjudicatory hearing, which is why we ask you to reconsider this issue.

Representative McGihon said I want clarify one thing. I'm not sure I heard

your statement about the rule-making correctly. Are you saying that the new rule-making is insufficient to solve these concerns? Mr. Wonstolen said no, I suggested there's a comprehensive scheme in place for involvement of the surface owner in the process up to the point of allowing the director to make the decision, after taking input into account, and providing some certainty to the operator that now we can proceed with our business activity. The new rule-making has taken that certainty away at the point the decision is made to approve the permit.

Senator Morse said what you're suggesting is that the surface owner's right of appeal that's proposed in these rules be eliminated. Can you balance that for me with why then wouldn't we take away the mineral owner's right to appeal as well? Mr. Wonstolen said for the mineral owner or the lessee operator who owns the right, it's their property right that's being regulated by the state. They're the ones who are asking for the permit to develop their property right, so I think it's a given in any sense of due process and the law that the property right exists independent of the state's police power. To the extent the state is exercising its police power to burden the exercise of your property right, you have a given right to say that the burden is being put on excessively or improperly and I have the right to redress on that. I don't think the two are comparable whatsoever.

Senator Morse said but once you get the permit, then you get to trample on the surface owner's rights, so doesn't that come back in and balance against it? Mr. Wonstolen said I would suggest under House Bill 07-1252 we do not get to trample on the surface owner's rights. We have an obligation that flows directly and specifically to the surface owner to make every reasonable accommodation to the surface owner's use of the surface that is technologically sound and economically practicable, as Representative Roberts has referenced. This legislature, over the years, has looked at this issue of the balance between the two estates and their rights and ultimately adopted House Bill 07-1252 to provide that sense of balance and any remedy for surface owners if they feel they have been trampled on.

Senator Mitchell said I arrive at the same place Mr. Wonstolen does, but by a slightly different route. I think the statutory framework already recognizes the interests of surface owners and I'm not quite clear that the extent of the right granted them creates a new protected class so much as it creates a disproportionate right to affect the process in a class that's already recognized. What I mean by that is if, for example, despite the broad latitude to regulate in this area granted the commission, the commission granted surface owners an outright veto power of developing the mineral interest, that would obviously

be outside the scope or reasonable reach of the commission's authority. I think Mr. Wonstolen's argument is that somewhere on that spectrum between the consultation that's provided for and outright veto power, this additional procedural ammunition granted surface owners to not only consult at the outset but to prolong an adversarial adjudicatory process at the end disproportionately favors, to the degree that it conflicts with the original statutory mandate, one class in this proceeding. That's how I see it. Tell me if that sounds reasonable or where I'm getting it wrong. Mr. Wonstolen said I'm happy to adopt your line of reasoning.

8:13 a.m. -- Stan Dempsey, President, Colorado Petroleum Association, testified before the Committee. He said in deference to the time, I'm just going to focus on one issue that we talked about in testimony a week and a half ago. Just to remind you, we were an active party in the rule-making and our members represent a broad spectrum of the folks who were part of the rule-making. The issue that we are still very concerned about is the application of the rules on federal lands. We brought to your attention a week and a half ago that there is a whole body of federal law as it pertains to the operations of oil and gas companies on federal lands. These state rules will, in some cases, contradict the federal rules. We gave you a specific example that, in terms of drilling close to streams, federal rules prohibit drilling any closer to streams than 125 feet without a variance but the state rules say 300 feet. That's a direct contradiction. I think the idea from the director of the commission was that there's going to be a memorandum of understanding (MOU) that's going to be executed by May 1, when the application of these rules takes place. I thought it was helpful in one regard to have the executive director of the department of natural resources bring a letter to you dated February 20, in which the federal bureau of land management (BLM) indicated that it had formerly reviewed the rules and they hoped to begin a more formal discussion. We read this letter with a great deal of concern that there will be no MOU executed by May 1. I think we're here to ask you as a committee to try to get more information from the director of the commission about the status of the MOU because we're gravely concerned about how these rules are going to apply in terms of how they're going to contradict. I think one of your roles as a committee is to make sure the rules don't contradict and putting anybody in a position of having to comply with two sets of rules. We would certainly beg for more information and more clarity whether these rules will be applicable on May 1 and whether there will be an MOU that clarifies that situation. We think the current application of these rules on federal lands invites litigation from any number of parties in terms of the relationship between the state and federal government and we think that is no good for the state, nor for our members who operate on federal lands. That is why we're here to object to the

application of the state rules on federal lands. We brought these issues to the commission, briefed them well, and would ask you to specifically take action to not have the rules apply on federal lands.

Representative McGihon asked if Mr. Dempsey is suggesting that it is not within the statutory authority of the commission to make a rule that applies a month later to federal land than one that applies to state land? Mr. Dempsey said I'm not arguing the terms of the time difference. I'm arguing that the state does not have the authority to impose these rules on federal lands.

Representative McGihon said you're not arguing the substance of the rule, you're telling us that the commission does not have the statutory authority. Mr. Dempsey said I'm arguing that the commission and the state do not have the statutory authority, and within your context of reviewing the rules, the rules are contradictory between the federal and state rules.

Representative McGihon said it's not so much that the rules are contradictory, it's that the state rules require additional feet away, which doesn't contradict, it's just more imposition. Is that correct? Mr. Dempsey said I think it not only does that but it puts an operator in a very difficult situation in terms of enforcement and there are different enforcement schemes that apply. One would not know which rule to adhere to.

Representative McGihon said I just have to say that the rules are not in contradiction, that obviously one would take the 300 feet away in order to comply with the rules, but I also think you're asking us with regard to that rule to do something that is beyond the scope of this Committee's authority, which is to look at the substance of the rule. Our review is to look at the statutory authority of the agency promulgating the rules and to make sure the rules are constitutional. That should be our focus. Mr. Dempsey said one of the legal mechanisms that the state is depending on to clarify the situation is the execution of an MOU. They brought this forward as a way to resolve that issue and we have no clue what the status of that MOU is and we think that is part of your review if the state is making the claim that the MOU is going to clarify the situation.

Representative Roberts asked how much overlap is there? Is there a percentage you can give us in terms of mineral development on federal land in the state of Colorado? Mr. Dempsey said I can't give you a specific percentage, but I know there is a body of law that the various federal agencies have and apply to the drilling activities on federal lands. We could provide you some sort of documentation of where those contradictions exist. We just

wanted to provide one example in our testimony from a week and a half ago.

Representative Roberts said my question was is there a single place in the state of Colorado where this potential conflict could occur or are there multiple places? Mr. Dempsey said we cited one example, we can provide additional concerns. I don't have them with me today.

Representative Roberts said I mean geographically. I don't mean in the rules. Seventy-six percent of my district is federal land so there's a lot of oil and natural gas development in mine. Is my district the anomaly in the state of Colorado or is this a bigger problem than the southwest corner? Mr. Dempsey said I believe the situation is particularly acute as well in the Piceance basin in western Colorado along with areas in your district. I'm not as familiar with other parts of the state, but there's a patchwork of both fee and federal lands that exist in the Piceance and Rio Blanco and Garfield counties.

Representative Roberts said on a different note, has the industry tried to be in touch with the newly appointed secretary of the interior to find out are they aware of the concerns here and the importance of the MOU? It seems to me there are a couple of places to try and push for that resolution. Mr. Dempsey said I think we have to go all the way back to the beginning of the hearings in which the BLM expressed very serious concerns in a letter that we had to petition the commission to put into the record. I think their position is well known. We've not formally contacted the secretary of the interior. I know there have been various educational forums in which practitioners of the law are getting perspectives, both from the state and federal government. The only thing we have recently to rely upon is this letter you were given dated February 20 from the BLM that talked about just beginning to sit down. We were told by the state that they were hoping to have something by March. This is very serious for us because we're really not going to be able to rectify which set of standards are going to apply to us in these federal areas.

Representative Gardner said I struggled with this issue both in the last hearing and on the floor of the House. I think I understand it. What I struggle with is how we, as a Committee or as a General Assembly doing rule review, can deal with this. One thing we did was attempt unsuccessfully to change the different effective dates, simply because it created an implication about federal applicability that I thought was inappropriate. We're somewhat limited other than an entire rule rewrite, which I don't think we can do through the rule review process. I think we can do it legislatively and mandate the rules. Is there someplace in the rules, short of striking all the rules, or maybe a set of places, that we could delete that would do what you think needs to be done?

If so, can you tell me where that is and why that is? Mr. Dempsey said our specific recommendation pertaining to this issue is to strike Rule 201A., which imposes the commission rules on federal lands and leases.

Representative Gardner said if I strike Rule 201A., I think that's the effective date provision. Am I correct? Mr. Dempsey said that may be the case. I don't have the rules right in front of me. I think what we're suggesting is to strike the application of the commission rules on federal lands.

Senator Veiga said Representative Gardner is correct. Rule 201A. is the effective date for both state and federal lands.

Representative Gardner said I carried an amendment to do that, and I thought it was appropriate. If anyone thinks the federal and state governments are going to get it done in a month more than what the rest is, they just don't have very much experience or they're a bleeding optimist. Short of striking the rule altogether and then begging the question, I'm not sure what else we do. Maybe that is the best approach. Mr. Dempsey said the other suggestion I'm making is that you as a Committee or as individual legislators really try to get the answer to when is the MOU going to be done. If you're accepting the argument from the state that the MOU really provides the framework for this cooperation between two very distinct governmental organizations, you really need to know when that MOU is going to be executed and when it's going to be applied. I don't think any of us know. Particularly in the regulated community, it would be helpful to hear what the status is and when that's going to be done. I would suggest that's really your oversight role. I do think that the other issue is you should be looking at this because I suspect the federal government may have its own legal position with regard to this as it wants to view how it responds to the application of these rules on federal lands.

8:28 a.m. -- Dave Neslin, Acting Director, Colorado Oil and Gas Conservation Commission and Assistant Director for Energy and Minerals of the Department of Natural Resources, testified before the Committee. He said I'll provide some background on the surface owner appeal provision and then respond to some of the points prior speakers have made. Under the rules as they existed prior to the recent rule-making, the only party that had a clear and broad right to an appeal to the commission from a decision on a drilling permit was the local government. Drilling permits are issued at the staff level. Typically, the commission does not review them or get involved in their consideration. The exception, as I mentioned, was a local government has the right to request a hearing on the issuance of a drilling permit. An operator had a very limited right. If the director withheld the issuance of a permit, the

operator could ask the commission to consider that withholding. The operator could not request the commission to review a condition that the director placed on a permit. So, if the director were to impose setback conditions, downhole casing or completion conditions, or other kinds of on-site mitigation conditions, the operator could not request a review of that by the commission. That's my opinion, that's the staff's opinion, and that's the attorney general's office's opinion. One of the things we did with these amendments was to broaden the appeal rights. I think it was the commission's belief that the two parties most affected by permitting decisions are the operator who, Mr. Wonstolen is correct, has a mineral interest that they are seeking to develop, and the surface owner, who also has a property interest that is inextricably bound up with the development of that mineral interest. I would disagree with Mr. Wonstolen that somehow the state is only regulating the operator's property rights. I think the state inescapably is also regulating the surface owner's property rights as well. Those are the two parties most directly affected by the permitting decision. We believe that both parties should have a right to appeal that decision to the commission in appropriate circumstances. For the surface owner, that's a limited right. They can't bring what I would refer to as reasonable accommodation or contract issues to the commission. There's a separate process for that. They've got to appeal on the grounds that the staff's permitting decision is inconsistent with one of our rules, inconsistent with our statute, or would result in a significant impact to public health, safety, or welfare. That standard was actually recommended by the industry itself, as part of the rule-making process, as being the appropriate standard for a surface owner appeal. It's not that the industry supported a surface owner appeal, but if the surface owner were to have a right to appeal, the industry believed that was the appropriate standard and that is, in fact, the standard the commission adopted by way of this amendment. The granting of a right to appeal to the surface owner was strongly supported by the Colorado homebuilder's association, by the association of commercial contractors with the state, by various local governments including Gunnison county and, I believe, La Plata county although I didn't confirm that this morning, and by approximately 15 citizen and conservation groups. There was broad support for extending this appeal right to surface owners. Again, to the commission, it was a question of equity, fairness, and efficiency in allowing those parties most directly affected by the decision to have a right to appeal that decision. That's important, as Representative Levy was noting, because administrative appeals are quicker, they're less expensive, and they're a more efficient way of resolving disputes or concerns than someone going to court and filing a lawsuit. The commission believes it was simply good government to allow them to have access to the commission.

Mr. Neslin said let me respond to a couple of the arguments that were made previously. The Colorado oil and gas association's suggestion that there was some earlier memo from the Committee dealing with a separate statute and a separate agency we think is easily distinguishable here. I think Senator Morse pointed out that our statute grants us broad authority to establish our hearing procedures and hearing rights. Our statute also specifies that just because it provides us specific authority to do one particular matter does not limit or take away from our broad authority, including our broad authority to develop and administer a hearing process. That was not just our opinion, but that was the Office's opinion in their memorandum to you. House Bill 07-1252 has no application here. We've not granted the surface owner a right to bring reasonable accommodation or contract issues to the commission. The attorney general's office addressed this issue specifically in their advice to the commission. In the rule-making process the attorney general's office's opinion was that House Bill 07-1252 raised separate issues and was not implicated by this administrative appeal right. Representative Roberts had asked about whether this would create a disincentive for operators to reach surface use agreements with the surface owners. I have to say I believe this will create a greater incentive. I was at a seminar, a largely industry-run and industry-presented seminar, through the Rocky Mountain mineral law foundation several weeks ago on the amended rules and that was, in fact, the advice industry attorneys were presenting at the seminar, which was surface owners are going to have more rights, they're going to have more individualized notice, and so it is going to be in the operators' interests to do surface use agreements and to work out issues ahead of time. Senator Morse, the question had come up about what is the practical effect of this in terms of delaying drilling. I think you're correct. I think there's very little practical effect. If a surface owner wants to get a hearing before the commission, they have to request that hearing in 10 days. The commission meets every five weeks, and so the longest there could be before a hearing would be scheduled would be five weeks. The commission also holds special hearings where it's appropriate or necessary and so I think five weeks would be the outside, but not the routine, period of time for the commission to take action on the hearing request, so it's going to be a prompt hearing. Very few wells are drilled within 90 days of the date the permit is issued. I won't disagree with Mr. Wonstolen. I'm sure there are a handful of small operators who drill their wells more quickly than that, but I've seen presentations made by Mr. Wonstolen himself talking about the process that operators go through in drilling wells and it involves not just getting our drilling permit but getting other regulatory approvals at the federal, state, or local level, it involves budgeting for the drilling operation itself, which out on the west slope can cost a million and a half to two million dollars - it's a substantial undertaking - and it involves

lining up drilling rigs and drilling crews. My point is that a permit is necessary but it's not sufficient for the drilling of the well. In most cases, the well is not drilled within 90 days of the date the permit is issued. The fact that a surface owner might have a right to request a hearing and then get a prompt hearing before our commission shouldn't take away from that. In addition, there is a preexisting rule which we retained in the rules, Rule 303.l., which allows for the immediate issuance of permits under exigent circumstances or where the leasehold owner stands to lose their leasehold right. It allows us to immediately issue a permit without the kind of notice and involvement of the other state agencies and surface owners. We think that operators are protected appropriately. Again, the arguments about efficiency would work against the operator having an appeal right as well. I do think there is kind of a level playing field issue here. What's good for the goose is good for the gander. The operator should have a right to appeal the commission's permit conditions if they disagree with them or if they think we're being arbitrary or capricious, but the surface owner should have the same right. The exercise of that surface owner's right is going to create no more uncertainty or be no more inconsistent with a timely and efficient process than will the operator's exercise of its administrative appeal rights.

Mr. Neslin said now I'll respond very briefly to the concerns expressed by the Colorado petroleum association regarding the application of the rules to federal land. As I pointed out during my prior testimony, we have for a long time issued drilling permits on federal land, so we apply our rules and our program to federal land. There is a supreme court decision, *California Coastal Commission v. Granite Rock Co.*, which specifically holds that states have the right to apply their environmental regulations to federal land. What we're talking about here, ultimately, is environmental health safety regulations. The attorney general's office prepared a lengthy opinion to the commission on this issue. The attorney general's office believes we have the right to apply our rules to federal land. Other states apply their rules to federal and. While I can respect the fact that Mr. Dempsey may disagree with that, I think the great weight of legal authority supports our position on that issue. I just don't think it's really debatable at this point that somehow the state doesn't have jurisdiction. We are working on an MOU. I wasn't aware there would be testimony taken today, so I did not try to confirm the status of that. I've been out doing rules training for the last week and a half around the state. I just came back from Grand Junction yesterday where we were working with operators and educating them on the amended rules. I'm not sure of the status of the MOU, but I can tell you what I told Mr. Dempsey's attorney about 10 days ago, which is if we do not make sufficient progress, then I will recommend that the effective date of the rules on federal land be further

deferred beyond May 1, and that I expect this is an issue the commission will consider at its hearing in approximately 10 days. I think the hearing is on March 30. We believe that we can deal with this issue and that it's not going to cause the kind of concern or problem that Mr. Dempsey is suggesting. Representative Roberts had asked about how many permits are we really talking about and it's about 15% of the permits we issue on federal land. That holds fairly constant, meaning even out on the Piceance basin on the west slope where there's a lot of federal land, it's about 15% of the permits that we issue. I would finally note that striking Rule 201A., by striking the effective date, my own interpretation of that would be to make the rules immediately effective on all land and I don't think that's what you're intending.

Senator Mitchell said Mr. Neslin's testimony makes me think of a few of points. One, your observation that these permits generally have been approved by staff I think underscores an important point that the industry has been making all along, which is that this has not traditionally been an adversarial or adjudicatory process. It has been a permit granting a rightholder the approval to do something they have the right to do and it happens at staff level because it's like most other government licenses or permits where you show a few appropriate conditions, show compliance with the law, and then proceed to exercise your rights. This whole process, I think, turns that on its head. Point number two, we talked about expanded appeal rights of mineral interest owners. They certainly don't feel like they're coming to this table with an expanded bag of tools. I think what's happening is there is a new array of substantive and procedural obstacles thrown at them and they are given some ability to counter or to check the onslaught. If you face a battery of new requirements but you're given an umbrella, it's not like you have additional strength in the process, it's just like there is some minimal check given to try and deal with the new hurdles thrown at you. Finally, point number three, I think is related to point number one, and that is that the whole direction this is going - the rules and the implementation of the statute - takes it further from the concept of a rightholder receiving efficient government approval to develop an important resource consistent with their legal, property, and constitutional rights and instead creates a legal jump ball with uncertainty, with protracted process, with adversarial friction along the way, and it seems all designed to obstruct, increase expense, and minimize the development of critical natural resources in Colorado.

Mr. Neslin said as to your first point, what I understand you saying is that we're making what was a kind of administerial process into a more adversarial process. I think we have to recognize that the industry has evolved. Ten years ago we were issuing 1,000 permits a year. Last year we issued 8,000 permits

for the year. Historically, a lot of the gas development occurred in northern Colorado and down in the southwest corner of the state. Now we have a lot more development occurring out on the west slope, in very different conditions, with higher elevations, steeper topography, other wildlife resources, drinking water supplies, and recreational uses being implicated. There are more difficult balancing issues to be addressed. I think the new rules try to take account of that. We've tried to fit new requirements to particular circumstances, so what we're requiring out on the west slope in the Piceance basin in many cases is not going to be required up in Yuma county or Weld county because there are different circumstances there, there are different resources, and there are different issues. We have tried to tailor the requirements to the particular part of the state we're talking about and the particular issues and resources of concern. I guess I would disagree with you. I appreciate that the process is becoming a more extensive process because we've added some new requirements, but we believe these are appropriate requirements and we believe they're consistent with our statutory mandate, which is the responsible development of our oil and gas resources in a way that protects public health, safety, and welfare, and we can do both. I think that would also be my point to your third point, which was we're creating too much uncertainty with this. Our rules have always provided flexibility, insofar as they've allowed us to grant exceptions, variances, and waivers to particular regulatory requirements. The industry has always supported that. They've always believed that's important so we can fit solutions to particular circumstances and we're not over-regulating or taking a one size fits all approach to an issue. We carried that forward here, with these amendments. Many of the amendments provide for waivers, variances, or exceptions in appropriate circumstances. We support that. We think it's going to help us achieve the kinds of win-win solutions that I've mentioned, where we're working with operators and other affected parties to regulate development in a way that allows the resource to be developed but also does a better job of protecting public health, safety, and welfare. With respect to your second point about the operators' right to an appeal and this is kind of an umbrella given all the changes, I think I would agree with you. We have made a number of changes. We do believe that it's appropriate for operators to have the right to appeal our decisions at the staff level to the commission, if they disagree with a condition we're imposing or if they disagree with the action the commission is taking on a permit or if we haven't taken timely action on their application. We've given operators the right to a prompt hearing if we don't act upon a permit within 75 days. By the same token, we think that providing a limited right of access to the commission for surface owners is also appropriate for the reasons I've stated.

Senator Mitchell said I appreciate that final acknowledgment. I guess it leads me to the conclusion that it kind of mischaracterizes to say operators have expanded appeal rights as if they've somehow been empowered in this process. What they do have is some minimal checking defense against the huge new burdens that are being dumped on them. Mr. Neslin said I would disagree that huge new burdens are being dumped upon them. We are requiring some new things. Where we're requiring new requirements we've incorporated the industry's own language. An example is the chemical disclosure rule and the drinking water protection rule. We incorporated almost 100% of the industry's language on those rules verbatim because we wanted to ensure that they would be workable rules. I could go through other rules, like the notice rule, Rule 305, where we incorporated a lot of the industry's language. In the wildlife rules, we incorporated a lot of the industry's language. I don't think they're being dumped on or it's unreasonable to expect them to do these things. Many of the requirements the better-performing operators are already doing within the state. I do disagree with you also that the operators' appeal rights have not been expanded here. According to our staff, they have been, and according to the attorney general's office they have been. We think that's appropriate. I think we should recognize that it does grant them rights they didn't have before.

Representative Roberts said please don't feel compelled to respond because I know there are people behind me on questions, so I'll make mine more of a statement. I completely appreciate the challenges you were faced with. When I worked on House Bill 07-1252, I had a much shorter time frame, which was a session, and I didn't have staff to do it, but it was all about balance. I think that's what you have been trying to do, but because of that firsthand experience I had in trying to find that balance between industry and surface owners, I have to disagree with you in terms of what the appeal process does for the surface owner. I do think the surface owner will not get as good an offer with that appeal right because as attorneys know, you never get the best offer right off the bat. If there's another shot, it's always on the steps of the courthouse right before the trial begins that you get the thing closest to what you actually wanted. I am concerned that actually, although well-intended, the appeal right undermines getting to the best surface use agreement that they could get. My second point was, again, I'm a very big advocate on leveling the playing field for surface owners, but I fail to see what a surface owner brings in terms of qualifications to argue for public health or wildlife when we now have the division of wildlife and the department of public health and environment at the table - and I'm in favor of that - and giving input in the process. If the concern that the surface owner brings up as part of an appeal was not previously bought into by the division of wildlife or the department of public health and

environment in that earlier consultation, it suggests to me that there isn't the science or background to support that concern, so why would a surface owner have the ability to stop that process if the very people on the commission now didn't feel like it rose to a level of having the permit denied? Again, I appreciate the trouble and the tricks to balancing and I think most of it was hit here, but I am concerned about some of the things that currently remain in the rules.

Mr. Neslin said I certainly respect your position. I would disagree. I think it's going to be in the operators' interest to resolve their issues with the surface owners at the outset and by doing so take the surface owners out of the picture and eliminate any uncertainty that might be associated with the surface owner appeal. The other two agencies are part of the process. We are proposing an amendment, as you know, as we discussed at the last meeting, that would eliminate their right to a hearing before the commission, so they could not go to the commission if they disagree. The surface owner may identify an issue that the other two agencies or our staff have missed, just like the operator may identify an issue that our staff has missed. I think the same argument would apply to an operator as well. An operator may say your condition is arbitrary and capricious, but our staff will have already considered that condition and we may have discussed the condition with the attorney general's office. One could argue that the odds of them being right are not great odds, either, and so, therefore, they shouldn't have a right to an appeal using the same logic. I believe it's appropriate to allow the operator or allow the surface owner to request an appeal. I don't think it's stopping the permit. I think it is creating a small, modest delay of something on the order of 20 to 40 days.

Senator Schwartz asked if 15% of the permits may be effected by the MOU, to what extent within the rules are we seeing inconsistencies with the federal rules and to what extent are our rules more stringent? Mr. Neslin said it's difficult to give you a generalized answer to that. It would depend on the series. The BLM has more stringent wildlife rules. We talked about that a little bit at the last meeting. I think probably our drinking water protection rules are more stringent than the BLM rules, so it would vary.

Senator Brophy said you spoke at length about the appeal process for surface owners and operators. Let me get a sense from you, and if you would answer with a yes or no that you can expand on as you desire, is it the intention now that we remove from the appeal process both the department of public health and environment and the division of wildlife? Mr. Neslin said yes, we have noticed a rule-making hearing for the end of May for that purpose. That will be our recommendation.

Representative Gardner said along those lines, I'm curious. As you know on March 6 I strived mightily to have those two provisions removed from the rules and I received the testimony that those rules were fully justified, fully legal, and I think the commission was quite confident that the balance had been struck properly and appropriately. I was shocked, amazed, and bemused by the notice of rule-making the day before those came to the floor of the House. Perhaps you can shed some insight on what occurred. Mr. Neslin said maybe you were more persuasive than you thought. I think it's a difficult issue. As I testified last time, I think one can argue that in terms of allowing for consultation with the commission, it's appropriate to allow the two agencies to have an administrative appeal right for that purpose and also to ensure a level playing field. At the same time, to the extent that they have issues with the resolution of the consultation, the director of each agency sits on the commission and can urge the commission on its own volition to hold a hearing on the application. The commission can always, by a majority vote, decide to hold a hearing on a particular matter and so their interests are adequately protected in that matter.

Senator Morse thanked Mr. Neslin for being here and for doing a good job of addressing all the questions Senator Morse asked the industry. I agree with Representative Roberts. I don't think the surface owner probably ought to have an appeal right, but hopefully we can work on that over the next week or so. I will vote yes on the bill today, but hopefully we can figure that out and maybe it will take the same path the division of wildlife and the department of public health and environment took.

8:58 a.m.

Hearing no further discussion or testimony, Representative McGihon moved to send House Bill 09-1292 to the floor with a favorable recommendation. The motion passed on a 7-3 vote, with Representative Labuda, Representative Levy, Representative Roberts, Representative McGihon, Senator Morse, Senator Schwartz, and Senator Veiga voting yes and Representative Gardner, Senator Brophy, and Senator Mitchell voting no.

8:59 a.m.

The Committee adjourned.